HARRISONS & CROSFIELD (M) SDN. BHD. v. DIRECTOR-GENERAL OF INLAND REVENUE

[A.C.J. (Harun J.) February 9, 1987]

[Kuala Lumpur – Tax Appeal No. A5/83]

Revenue Law – Additional remuneration – "Bonus" – Whether additional remuneration – Meaning of bonus – Income Tax Act, 1967, ss. 33 & 39(1)(h).

This was an appeal from the Special Commissioners of Income Tax against their (majority) Deciding Order in confirming the assessment for the year of assessment 1975 raised by the Revenue in 1981 on the appellant company. The subject matter of this appeal was in respect of that part of the assessment which disallowed a deduction of $671,091 (known as Additional Remuneration) from the gross income paid to the senior executives of the appellant company.

The issue before the court was whether this Additional Remuneration is a bonus within the meaning of the section 39(1)(h) of the Income Tax Act, 1967.

Held, allowing the appeal: (1) section 39(1)(h) clearly contemplates "bonus" to be a payment over and above the remuneration agreed. It applies to bonus payments in respect of junior executives and non-managerial staff because the discretionary bonus payments are made over and above the agreed remuneration. It does not apply to senior executives because the fixed salary and the Additional Remuneration paid to them is the agreed remuneration and nothing is paid over and above that;

(2) the payments made by the appellant under the Additional Remuneration Scheme for senior executives should accordingly be allowed as an expense wholly and exclusively incurred in the production of gross income of the appellant pursuant to section 33 of the Income Tax Act, 1967.

Cases referred to:

(1) *Shelford* v. *Mosey* [1917] 1 K.B. 154.
(2) *Sutton* v. *Attorney-General* (1923) 39 T.L.R. 294.

TAX APPEAL.

Michael Wong for the appellant.
Zulkefli b. Ahmad Makinuddin (Senior Federal Counsel) for the respondent.

Cur. Adv. Vult.

Harun J.: This is an appeal from the Special Commissioners of Income Tax against their (majority) Deciding Order in confirming the assessment for the year of assessment 1975 raised by the Revenue in 1981 on the appellant. The subject-matter of this appeal is in respect of that part of the assessment which disallowed a deduction of $671,091.00 from the gross income paid to the senior executives of the appellant company.

The appellant does not dispute the following primary facts as found by the Special Commissioners –

"(i) the appellant is a company incorporated in Malaysia;

(ii) during the basis year for the year of assessment 1975 i.e. July 1, 1973 to June 30, 1974 and prior to and after that date all the appellant's expatriate senior executives and a local senior executive on the management staff were paid remuneration as follows:–

(a) a fixed salary
(b) an overseas allowance
(c) an educational allowance for their children
(d) an additional remuneration (hereinafter referred to as "AR") which varies from one senior executive to another senior executive;

(iii) the AR was payable under a scheme called the Additional Remuneration Scheme (hereinafter referred to as "the AR scheme") which was formulated in 1935. The rules of the scheme were revised in 1962 (page 3 of Agreed Bundle);

(iv) when a senior executive was first employed he would receive *inter alia* (e.g. educational allowance) "fixed salary" and AR as stated so in his letter of appointment (exhibit A3);

(v) when the senior executive's tour of service was extended his level of the AR would be negotiated with him. The amount agreed would be added to his increased "fixed salary" and the total of both would be shown in his contract of employment and regarded by the appellant as his remuneration (page 7 of Agreed Bundle). The market value of each senior executive would comprise his basic salary and in addition his AR;

(vi) the AR was based upon a percentage of the combined audited profits of the Appellant, Harrisons & Crosfield (Singapore) Pte Ltd. and Penyedian Kimia Sdn. Bhd. and was paid as an incentive to those who had an impact on profits, i.e. senior executives;

(vii) negotiation as to the rate under the AR scheme with each expatriate senior executive was done in London during his leave after his tour of service;

(viii) negotiation with the local senior executive was done by correspondence with London Office;

(ix) the junior executives were not eligible for the AR scheme on first appointment. After four years' service the expatriates who had served as junior executives for four years would be entitled to participate in the AR scheme.

(x) the junior executives and non-managerial staff were paid bonus at the discretion of the appellant;

(xi) it was the practice to pay the junior executives and non-managerial staff annual bonus of two months salary;

(xii) the appellant did not dispute that the discretionary payments to its junior executives constitutes bonus and would be subject to the provisions of section 39(1)(h) of the Act, if applicable, in regard to the quantum;

(xiii) the employees of the appellant paid under the AR scheme were not eligible to receive bonus paid to junior executives and non-managerial staff. They were not allowed to opt for the said bonus instead of the AR and neither were they allowed to receive a higher basic salary without the AR;

(xiv) the employees of the appellant paid under the AR scheme would receive more monetarily than if they were paid bonus payable to junior executives and non-managerial staff;

(xv) it is inferred that the AR which is paid as a percentage of profits under the AR scheme is more appropriate for senior executives who have an impact on profits than for junior executives and non-managerial staff who are paid an annual sum which is a multiple of their respective salaries;

(xvi) for the year of assessment 1975 there were approximately 450 executives employed by the appellant out of which only 21 (20 expatriates and 1 local) were senior executives who were entitled to and paid under the AR scheme. The remainder, out of which only two were expatriates, were paid bonus payable to junior executives and non-managerial staff;

(xvii) the AR paid by the appellant to the 21 senior executives for the relevant year of assessment was $671,091.00;

(xviii) the appellant was allowed a deduction of $96,855.00 which was equivalent to two-twelfths of the salaries paid to the 21 senior executives for the relevant year of assessment as prescribed in section 39(1)(h) of the Income Tax Act, 1967;"

On these facts, the Special Commissioners stated that the issue before them was whether the Additional Remuneration paid under the Additional Remuneration Scheme by the appellant was –

"(i) a commission or deferred wage payment and therefore deductible as an expense wholly and exclusively incurred in the production of gross income of the Appellant within the meaning of section 33 of the Income Tax Act, 1967; or

(ii) a bonus payment pursuant to section 39(1)(h) of the Act and therefore be disallowed as a deductible expense beyond the limits stipulated therein."

The appellant contends that the Special Commissioners have framed the issue wrongly and therefore their conclusions must be wrong. The appellant also says that the Special Commissioners have made wrong inferences from the facts as found by them.

The instant case arises from an amendment to the Income Tax Act in 1975 restricting payment of *bonus* to two-twelfths of salary or wages. In my view, the only issue in this appeal is whether or not the Additional Remuneration paid to the senior executives is a *bonus* within the meaning of section 39(1)(h) of the Act. The onus of proving that the assessment is erroneous is clearly on the appellant: para 13 of Schedule 5 of the Act. The appellant must prove that the payment is not a bonus but there is no onus on the appellant that the payment is something else. I therefore hold that whether the payment is a commission or deferred salary is irrelevant to the issue before the Special Commissioners.

The word "bonus" is not defined in the Act. The general rule is that words in a statute should be given their ordinary meaning. The *Shorter Oxford Dictionary* defines – *"Bonus* — A boon or gift over and above what is normally due. A premium for services rendered or expected." From this definition the Special Commissioners concluded that bonus includes any payment –

(a) In addition to 'fixed salary'; and

(b) Made under a legal obligation.

If any payment in addition to fixed salary is a bonus, then that would include the educational allowance paid in this case. Even the Revenue has not gone that far. If it also includes any payment made under a legal obligation, that is to say, if the payment is *contractual,* then it is a contradiction in terms to speak of a contractual bonus because bonus by definition is gratuitous and there cannot be a contract to do something which is not expected. The definition "A premium for services rendered or expected" does not mean a legal obligation to pay but is a token of appreciation for something done or expected to be done as opposed to giving charity to the blind.

In the context of section 39(1)(h) I am of the view that a distinctive feature that remuneration is not a bonus is if the payment is contractual. In the instant case, the junior executives and non-managerial staff were paid an annual bonus of two months salary at the *discretion* of the appellant. That truly is a bonus because the payment is

gratuitous and non-contractual. The Additional Remuneration Scheme, on the other hand, is contractual and is a distinct component of the senior executives remuneration consisting of a fixed monthly salary and the variable Additional Remuneration. As found by the Special Commissioners, the combined total of fixed salary and Additional Remuneration represents "the market value" of each executive. The fact that the Additional Remuneration is related to and a percentage of profits does not make the payment a bonus. The argument that just because discretionary bonus payments are made only when the Company makes a profit and therefore Additional Remuneration being also related to profits must necessarily be bonus is fallacious because the conditions for payment are entirely different. Contractual payments related to profits is no different from payment of commissions to salesmen based on actual sales; or the incentive payments to rubber-tappers for bringing in latex in excess of a fixed daily pondage; or the incentive payments to textile workers in excess of the number of the fixed daily average of garments. In all these cases the employees also receive a fixed monthly salary or daily wage.

It is also argued that just because the senior executives are not entitled to the discretionary annual bonus payments therefore the Additional Remuneration must be bonus. There is no merit in this argument for the simple reason that the bonus is gratuitous and the Additional Remuneration is contractual. The Special Commissioners are also in error in holding that as the Additional Remuneration is not a commission it must therefore be a bonus. They were again in error in holding that if the Additional Remuneration is not bonus, then the appellant should have increased the fixed salary because in doing so the reason and the basis of the payment, *viz.*, as found by the Special Commissioners "paid as an incentive to those who had an impact on profits" would be removed.

The cases of *Shelford* v. *Mosey*[1] and *Sutton* v. *A.G.*[2] do not assist the Revenue. In *Shelford's* case, the court said that 'bonus' in such a case as the present one is in truth nothing else but an euphemism for addition to wages and proceeded to hold that the wartime bonus were in fact wages. In *Sutton's* Case, Lord Birkenhead said:

"I have no doubt that the war bonuses were part of the civilian's pay." He went on to say "The term 'bonus' may, of course, be properly used to describe payments made of grace and not as of right. But it nevertheless may also include, as here, payments made because legally due, but which the parties contemplate will not continue indefinitely."

Both these cases illustrate the misuse of the word "bonus" in the sense although implying a gift but on the facts were contractual. In this country too the word "bonus" is often misused in contracts of employment where the contracts provide for the payment of two months' salary as bonus each year whether the Company makes a profit or not. Such payments in truth are deferred salary.

Section 39(1)(h) clearly contemplates 'bonus' to be a payment over and above the *remuneration agreed*. It applies to the bonus payments in respect of junior executives and non-managerial staff because the discretionary bonus payments are made over and above the agreed remuneration. It does not apply to senior executives because the fixed salary and the Additional Remuneration paid to them is the agreed remuneration and nothing is paid over and above that.

For these reasons, I would allow the appeal with costs here and below. The payments made by the appellant under the Additional Remuneration Scheme for senior executives should accordingly be allowed as an expense wholly and exclusively incurred in the production of gross income of the appellant pursuant to section 33 of the Income Tax Act, 1967.

Order accordingly.

Solicitors: *Shook Lin & Bok.*